

16 June 1989

TRANSITION TO COMMUNITY CHARGE: IMPACT ON RPI IN APRIL 1990

At her meeting on 25 May to discuss next year's local authority grant settlement, the Prime Minister emphasised the importance of ensuring that the basis on which the Community Charge was included in the RPI was technically correct and did not give rise to any overstatement of the index.

I have prepared the attached note on this. I have cleared it with D.Em statisticians. You may care to draw it to the Prime Minister's attention for next week's briefing meeting.

The importance of as low an average charge as possible is self-evident. At £300, the impact on the RPI next April will be the same (0.4) as a 10% average increase in rates. (This year's rates increase was 9.6%).

You will recall that the current estimated range for average community charge based on the grant settlement coming forward to E(LF) is £285-310. This would represent 0.3-0.7 on the RPI. But if the average charge crept up to £320, which is certainly an entirely plausible outcome, it would equate to an 18% increase in rates and put almost a whole percentage point on next April's index.

As you know, the methodology regarding the treatment of Community Charge in the RPI has been agreed by the RPI Advisory Committee, accepted by Ministers and published. Transitions are always difficult, but I am concerned that there is no way of offsetting the "inflationary" impact

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by reference to the benefits of the Community Charge for many people, especially pensioners. The 1986 Green Paper emphasised that 85% of pensioner households would benefit. There must be a danger of this getting lost amid accusations of the Government stoking inflation.

The attached chart from 'Public Finance and Accountancy' illustrates the extent to which there are as many, if not more gainers as losers. (Note how the gainers are concentrated in the high rate areas of the South East).

Nor will the RPI reflect in any way the impact of Community Charge rebates. Average household expenditure on the Charge for index purposes will be calculated without reference to rebate. Yet the Government has been at pains to emphasise that up to one in four people could benefit from rebates, which will be distinctly more generous than rate rebates.

CONCLUSION

There is a distinct probability that it will be possible for critics to characterise the Community Charge next April as "inflationary" because of the way it will be measured by the RPI. It is evident that the RPI will not be able to reflect the reduction in costs which many people, especially pensioners, will experience.

I doubt it is possible for the methodology to be reopened at this stage and the only way forward is therefore

- to ensure that the average charge is as low as possible (and certainly not higher than £300);
- forceful publicity of the beneficial impact on groups such as pensioners.

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## TRANSITION TO COMMUNITY CHARGE: EFFECTS ON RPI, APRIL 1990

The transition methodology agreed by the RPI Advisory Committee and accepted by Ministers is to compare average rates per index household this year with average community charge next year. Index households exclude the top 4% income bracket and those pensioners mainly dependent on state benefits, thus accentuating slightly the impact on measured inflation since both groups gain from the introduction of the charge.

On this methodology the RPI effects in April 1990, for various levels of average community charge, will be as follows:

<u>Average rates</u> <u>per index household</u> <u>1989/90</u>	<u>Average CC%</u> <u>per adult</u> <u>in E &amp; W</u> <u>in 1990-91*</u>	<u>% increase in RPI</u>	
		<u>Rates</u> <u>&amp; CC</u>	<u>All</u> <u>items</u>
502	280	4	0.2
	300	11	0.5
	320	19	0.9
	340	26	1.2

\* (multiplied by 1.8 to get average per index household)  
With average CC at £300 the RPI impact would be similar to that in April 1989 (9.6% on rates/CC, 0.4% on all items) but as the average moves above £300 the impact looks increasingly politically sensitive.

The above assumes, realistically, that the weight for rates/CC in the RPI will increase slightly from the present 45 parts per thousand.

A legitimate criticism of the transition methodology is that it fails to pick up the benefits of the change to CC

for some people, especially single pensioners. The 1986 Green Paper on paying for local government estimated that 85 per cent of pensioner households would gain from the CC, some quite substantially, and that there would be a broad overall balance between gainers and losers, yet the CC may well be characterised next April as seriously "inflationary".

This analysis underlines the crucial need to ensure that the average CC figure is kept as low as possible, and certainly not higher than about £300.